

STEPTOE & JOHNSON LLP

ATTORNEYS AT LAW

1330 CONNECTICUT AVENUE, N.W.
WASHINGTON, D.C. 20036-1795

PHOENIX, ARIZONA
TWO RENAISSANCE SQUARE

TELEPHONE: (602) 257-5200
FACSIMILE: (602) 257-5299

ALFRED M. MAMLET
(202) 429-6205
amamlet@steptoe.com

(202) 429-3000
FACSIMILE: (202) 429-3902
TELEX: 89-2503

STEPTOE & JOHNSON INTERNATIONAL
AFFILIATE IN MOSCOW, RUSSIA

TELEPHONE: (011-7-501) 258-5250
FACSIMILE: (011-7-501) 258-5251

March 31, 1997

VIA HAND DELIVERY

Mr. William Caton
Acting Secretary
Federal Communications Commission
Room 222
1919 M Street, N.W.
Washington, D.C. 20554

**Re: Telefónica Internacional de España, S.A.'s Reply Comments
In The Matter Of International Settlement Rates
IB Docket No. 96-261**

Dear Mr. Caton:

Telefónica Internacional de España, S.A. ("TI"), by its attorneys, hereby submits for filing an original and five copies of their Reply Comments in connection with the above-captioned matter.

Also enclosed is an additional copy of TI's Reply Comments which we ask you to date stamp and return with our messenger.

If you have any questions, please do not hesitate to contact me.

Respectfully submitted,

Alfred M. Mamlet /cs

Alfred M. Mamlet
Counsel for Telefónica Internacional
de España, S.A.

/srh-m
Enclosures

No. of Copies rec'd _____
List ABCDE _____

RECEIVED

MAR 31 1997

Federal Communications Commission
Office of Secretary

005

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

RECEIVED

MAR 31 1997

*Federal Communications Commission
Office of Secretary*

In the Matter of

International Settlement Rates

IB Docket No. 96-261

**REPLY COMMENTS OF TELEFÓNICA
INTERNACIONAL DE ESPAÑA, S.A.**

**TELEFÓNICA INTERNACIONAL
DE ESPAÑA, S.A.**

**Luis López-van Dam
General Secretary
Telefónica Internacional
de España, S.A.
Jorge Manrique, 12
Madrid 28006
SPAIN**

**Alfred M. Mamlet
Maury D. Shenk
Kent D. Bressie
Colleen A. Sechrest
Steptoe & Johnson LLP
1330 Connecticut Avenue, N.W.
Washington, D.C. 20036
(202) 429-3000**

Dated: March 31, 1997

TABLE OF CONTENTS

	<u>Page</u>
I. Introduction And Summary	1
II. The Recent WTO Telecom Agreement Underscores The Need For A Multilateral Approach To Settlement Rate Reform	5
A. Multilateral Support Is Essential For Achieving Settlement Rate Reform	5
B. The Commission Should Focus On Increasing Competition Consistent With The WTO Telecom Agreement, Not On Increasing Regulation	7
III. The NPRM's Proposals Are Inconsistent With The General Agreement On Trade In Services	10
A. The Most-Favored Nation Treatment Obligation Prohibits Discrimination Among Foreign Services Or Service Suppliers From Different Countries	10
1. The NPRM'S Proposed Conditions On Service Authorization Discriminate Against International Services And International Service Suppliers On Particular Routes	11
2. The Proposed Settlement Rate Benchmarks Vary Arbitrarily From Cost	12
B. The WTO Telecom Agreement Imposes Additional Obligations On The United States	14
1. The NPRM's Proposals Would Violate The U.S. GATS Commitment Of National Treatment	15
2. The NPRM'S Proposals Would Violate The U.S. GATS Commitment Of Market Access	17

	<u>Page</u>
C. The NPRM's Proposals Are Not Permissible Under Any GATS Exception	19
1. Article VI Of The GATS Does Not Provide An Exception To The Obligations Of MFN Treatment, Market Access, Or National Treatment	20
2. There Is No "Competition Exception" Under The GATS	21
IV. No Commenter Provided Any Legal Authority For The Commission To Enforce Mandatory Benchmarks Or Abrogate Existing Settlement Rate Agreements	22
A. The Communications Act Provisions Cited By AT&T And Sprint Do Not Allow The Commission To Invalidate Or Rewrite Existing Settlement Rate Agreements Between U.S. And Foreign Carriers	23
1. The Commission Lacks Jurisdiction Over Foreign Carriers Under Section 2 Of The Communications Act	23
2. The Commission Lacks The Authority To Prescribe Settlement Rates Under Section 201 Of The Communications Act	26
3. The Commission Lacks The Authority To Prescribe Settlement Rates Under Section 205 Of The Communications Act	28
B. AT&T Misrepresents The Obligations Of The U.S. Government Under The ITU Regulations	29
1. Statement No. 69 Is Not A U.S. Reservation To The ITU Regulations	30
2. The ITU Regulations Forbid, Rather Than Invite, Interference By Foreign Governments In A Carrier's Settlement Rate Practices	31

	<u>Page</u>
V. The Commission Should Impose Cost-Based Rates On U.S. Carriers Before Imposing Cost-Based Rates On Foreign Carriers	32
A. AT&T Has Not Passed All Settlement Rate Reductions Through To U.S. Consumers	34
B. AT&T Cannot Defend Its Large And Increasing Price-Cost Margin	37
VI. The Commission Should Tie Any Mandatory Settlement Rate Reform To Rate Rebalancing	40
VII. The Commission Should Not Condition The Authorizations Of Foreign-Affiliated Carriers On Settlement Rates Within The Benchmark	44
VIII. The Commission Has Not Developed A Record Which Supports Imposing Mandatory Benchmarks	50
IX. Conclusion	54

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

**In the Matter of

International Settlement Rates**

IB Docket No. 96-261

**REPLY COMMENTS OF TELEFÓNICA
INTERNACIONAL DE ESPAÑA, S.A.**

I. INTRODUCTION AND SUMMARY

The Commission must reconsider its approach to settlement rate reform in light of the February 15, 1997 World Trade Organization ("WTO") Agreement on Basic Telecommunications ("WTO Telecom Agreement"). As U.S. Trade Representative Charlene Barshefsky explained, "[t]his agreement represents a change of profound importance."^{1/} The WTO Telecom Agreement requires that settlement rate reform be pursued on a multilateral basis for at least three reasons. **First**, multilateralism works. The WTO Telecom Agreement is an achievement remarkable for both the breadth of its coverage and the breadth of its support. As with the WTO Telecom Agreement, the United States should work together with a large group of other countries to adopt and implement settlement rate reform on a multilateral basis. **Second**, the WTO Telecom

^{1/} U.S. Officials Say Delay Produced Better WTO Telecom Agreement, Inside U.S. Trade 1 (Feb. 18, 1997).

Agreement authorizes competition on a truly global basis. This competition will, of its own accord, lead to lower settlement rates and lower collection rates for international services. **Third**, the WTO Telecom Agreement imposes important obligations which preclude the United States from adopting the policies proposed in the Commission's Notice of Proposed Rulemaking.^{2/}

Quite apart from the WTO Telecom Agreement, the initial comments filed in response to the NPRM underscore the fact that the Commission lacks a sound legal or factual basis for adopting the proposed mandatory settlement rate benchmarks. Instead, they lay bare the attempts by AT&T and others to preserve their dominant and protected positions in the U.S. market while misdirecting the Commission's attention to carriers beyond its jurisdiction.

Part II addresses the impact on the WTO Telecom Agreement on settlement rate reform. Just as the WTO Telecom Agreement broke down barriers to entry on a multilateral basis, the Commission should work with other governments and carriers to tackle settlement rate reform. Indeed, now that global telecommunications competition is about to increase tremendously it is the worst possible moment to attempt to control settlement rates by unilateral regulatory fiat.

Part III establishes that the NPRM's proposals are inconsistent with the General Agreement on Trade in Services ("GATS") and with U.S. commitments made in the WTO Telecom Agreement. **First**, the NPRM's proposals would violate the United States' GATS obligation of most-favored nation ("MFN") treatment. This obligation prohibits discrimination among foreign services or service suppliers from different countries. The NPRM's proposed conditions on service authorizations would explicitly discriminate against international services and international service suppliers on particular routes. Furthermore, the NPRM's proposed settlement rate benchmarks

^{2/} International Settlement Rates: Notice of Proposed Rulemaking, FCC 96-484 (rel. Dec. 19, 1996) ("NPRM").

would effectively discriminate against international services and international service suppliers on particular routes by varying arbitrarily from cost. **Second**, the NPRM's proposals to condition market entry for foreign-affiliated carriers on benchmark compliance would violate the national treatment and market access obligations of the United States under GATS and the WTO Telecom Agreement. These obligations forbid such conditions that apply almost exclusively to foreign-affiliated carriers and create barriers to entry into the U.S. market. **Third**, the NPRM's proposals are not permissible under any GATS exception. The domestic regulation provisions of GATS article VI affirmatively require compliance with the obligations of most-favored nation ("MFN") treatment, market access, and national treatment. Finally, GATS does not permit GATS-inconsistent national regulations simply because they are characterized as pro-competitive.

Part IV establishes that the Commission has no legal authority to enforce mandatory benchmarks or abrogate existing accounting rate agreements. **First**, the Communications Act provisions cited in the initial comments of AT&T and Sprint do not allow the Commission to invalidate or rewrite existing accounting rate agreements between U.S. and foreign carriers. Section 2 of the Communications Act grants the Commission jurisdiction only over carriers engaged in foreign communications on U.S. territory, thus denying jurisdiction over foreign carriers that provide the foreign half-circuit terminating international calls only through their networks outside of the United States. Neither Section 201 nor Section 205 of the Communications Act grants the Commission authority to prescribe settlement rates. **Second**, AT&T misrepresents the binding treaty obligations of the U.S. Government in an attempt to explain away the NPRM's inconsistencies with the ITU Regulations. The U.S. Government statement cited by AT&T does not exempt the United States from any obligations under the ITU

Regulations. Moreover, the ITU Regulations explicitly forbid interference by foreign governments in a carrier's settlement rate practices.

Part V maintains that the Commission should impose cost-based rates on U.S. carriers before imposing cost-based rates on foreign carriers. Contrary to AT&T's erroneous claims, AT&T has not passed all settlement rate reductions through to U.S. consumers. More significantly, using AT&T's own calculations for outbound international traffic based on effective settlement rates, AT&T's 1995 price-cost margin of \$0.565 per minute was more than twice as large as the average price-cost margin for foreign carriers of \$0.245 per minute.

Part VI demonstrates that the Commission should tie any mandatory settlement rate reform to rate rebalancing. The ability of foreign carriers to reduce settlement rates depends on effective rate rebalancing in their home markets. This rebalancing in turn depends on resolution of a host of domestic political and economic issues which are the province of foreign governments, not carriers. An important example is offered by Argentina, where Telintar and several U.S. carriers entered into settlement agreements tying future settlement rate reductions to rate rebalancing. AT&T had previously criticized these agreements as having "no legal or practical value." Argentina's recent rate rebalancing, however, has permitted Telintar to offer dramatic settlement rate reductions of more than 40%. AT&T has rushed to join the other U.S. carriers in accepting these settlement rate reductions, which were tied to rate rebalancing. The Argentine experiment worked. It serves as an important model for accounting system reform on a multilateral basis. If the Commission persists in adopting an unilateral approach, then it should follow the Argentine example by tying mandatory settlement rate reductions to rate rebalancing.

Part VII establishes that the Commission should not condition the authorizations of foreign-affiliated carriers on settlement rates within the relevant

benchmarks. AT&T argues that conditions on authorizations are necessary to deter anticompetitive behavior, when in fact they are necessary simply to protect AT&T's profit margins and market shares. The conditions on authorization endorsed by AT&T would have the perverse effect of impeding competition in the U.S. and global telecommunications markets by stifling the entry of carriers who would otherwise seek to stimulate business and enhance market share through price competition with AT&T.

Part VIII demonstrates that the Commission has not developed a record which supports imposing mandatory cost-based benchmarks. The Commission admittedly does not have -- and cannot obtain -- accurate data on foreign carriers' costs. It thus proceeds to estimate these costs. The NPRM's estimation method, however, is riddled with conjecture and unverifiable information. Such a method cannot withstand judicial review.

II. THE RECENT WTO TELECOM AGREEMENT UNDERScores THE NEED FOR A MULTILATERAL APPROACH TO SETTLEMENT RATE REFORM

The recent WTO Telecom Agreement demonstrates that the Commission should pursue settlement rate reform based on the principles of multilateralism and competition. Adherence to these principles is absolutely essential for achieving sustainable, market-based reform.

A. Multilateral Support Is Essential For Achieving Settlement Rate Reform

Multilateral support is the essential ingredient for successful settlement rate reform. As the recent WTO Telecom Agreement demonstrates, multilateralism produces results -- remarkable results. In the words of U.S. Trade Representative Charlene Barshefsky, "This agreement represents a change of profound importance.

A 60-year tradition of telecommunications monopolies and closed markets has been replaced by market opening and competition -- the principles championed here and embodied in the 1996 Telecommunications Act."^{3/} If a multilateral effort can persuade countries around the world to abandon long-held governmental monopolies, then a multilateral effort can also persuade countries to reform settlement rates.

Commenters from more than fifty different countries, with more than half of all international traffic with the United States, emphasized the importance of proceeding with settlement rate reform on a multilateral basis.^{4/} Indeed, these comments establish that the only aspect of the Commission's NPRM that is multilateral is the virtually world-wide opposition to proposed unilateral imposition of mandatory benchmarks. This united opposition demonstrates that the NPRM's proposed unilateral

^{3/} U.S. Officials Say Delay Produced Better WTO Telecom Agreement, Inside U.S. Trade 1 (Feb. 18, 1997).

^{4/} See, e.g., Comments of Hong Kong Telecom International, IB Docket No. 96-261, at 28 (filed Feb. 7, 1997); Comments of SBC Communications, Inc., IB Docket No. 96-261, at 4 (filed Feb. 7, 1997); Comments of Kokusai Denshin Denwa Co. Ltd. ("KDD"), IB Docket No. 96-261, at 24 (filed Feb. 7, 1997); Comments of Deutsche Telekom Inc. North America, IB Docket No. 96-261, at 5 (filed Feb. 7, 1997); Comments of France Telecom, Inc., IB Docket No. 96-261, at 5 (filed Feb. 7, 1997); Comments of Portugal Telecom International, IB Docket No. 96-261, at 10 (filed Feb. 7, 1997); Comments of Telefónica del Perú, S.A. ("TDP"), IB Docket No. 96-261, at 13 (filed Feb. 7, 1997); Comments of Telecom Italia, IB Docket No. 96-261, at 2 (filed Feb. 5, 1997); Comments of International Telecom Japan, Inc. ("ITJ"), IB Docket No. 96-261, at 6 (filed Feb. 7, 1997); Comments of Regional Technical Commission on Telecommunications of Central America ("COMTELCA"), IB Docket No. 96-261, at 13 (filed Feb. 7, 1997); Comments of Telia AB, IB Docket No. 96-261, at 4 (filed Feb. 7, 1997); Comments of Communications Authority of Thailand, IB Docket No. 96-261, at 2 (filed Feb. 4, 1997); Comments of Directorate General of Telecommunications, P&T, People's Republic of China ("PRC P&T"), IB Docket No. 96-261, at 2 (filed Jan. 29, 1997); Comments of Embassy of the Republic of Korea, IB Docket No. 96-261, at 1 (filed Feb. 7, 1997); Comments of the Solomon Islands Government, IB Docket No. 96-261, at 1 (filed Feb. 6, 1997); Comments of Telecommunications Authority of Singapore, IB Docket No. 96-261, at 1 (filed Feb. 7, 1997); Comments of Videsh Sanchar Nigam Ltd. ("VNSL"), IB Docket No. 96-261, at 7 (filed Feb. 6, 1997); Comments of INDOSAT, IB Docket No. 96-261, at 1 (filed Feb. 6, 1997); Comments of Telefónica Internacional, S.A., IB Docket No. 96-261, at 32 (filed Feb. 7, 1997).

approach is politically impossible. The NPRM attempts to regulate the actions of foreign carriers and countries, and thus its success depends on the willingness of those carriers and countries to comply. That willingness is clearly lacking.

There is a willingness, however, to reform the accounting rate system multilaterally. In this regard, the ITU is already taking the steps necessary to facilitate such reform. As ITU Director General Pekka Tarjanne recently told the U.S. Department of State and FCC in response to the NPRM:

The ITU is taking the necessary action and I do hope that the FCC's final outcome on this issue will not threaten the viability of efforts carried out in our organization in this respect. At the same time, in the interest of facilitating the development of the global telecom industry and the markets it serves, I would officially invite the U.S. Government, as in the past, to contribute to the work of the Union in order to achieve the objective of reforming the accounting rate regime and to taken an active role in a constructive debate to attain a successful outcome on a multilateral basis.^{5/}

This is an invitation that the United States should not refuse, particularly since accounting rates may be the topic of the next World Telecommunications Policy Forum in Geneva in May 1998.^{6/}

B. The Commission Should Focus On Increasing Competition Consistent With The WTO Telecom Agreement, Not On Increasing Regulation

Instead of attempting unilaterally to regulate international settlement rates, the Commission should aim to preserve and foster the global commitments to competition that the United States won in the WTO negotiations. Such world-wide competition will render further regulation unnecessary. The practical implication of this

^{5/} Letter from Dr. Pekka Tarjanne to Ambassador Vonya B. McCann, U.S. Dep't of State, with copy to FCC Chairman Reed Hundt (Feb. 21, 1997) ("Comments of ITU").

^{6/} ITU May Tackle International Accounting Rate Reform at Next Policy Event, Communications Daily, Mar. 21, 1997, at 4.

achievement for U.S. consumers is lower international telephone costs -- a benefit recognized by FCC Chairman Reed Hundt when he stated: "Eventually, a dollar will become a dime."^{7/} In short, both the U.S. Administration and the FCC have acknowledged that the recently-achieved commitments to competition are the best and most direct route to increasing U.S. consumer welfare -- the same goal that the NPRM pursues by the misguided route of attempting to dictate international settlement rates.

Indeed, a commitment to competition has been central to the Commission's previous efforts to lower settlement rates:

[W]e believe the best way to create an alternative to the traditional accounting rate system is to introduce effective competition. Indeed, we believe that in competitive markets our benchmark rates would not be necessary because international call termination rates in such markets will be below any benchmark rates that we adopt.^{8/}

This statement reflects the fundamental philosophy of both the Commission and the WTO Telecom Agreement: competition produces efficient markets. It is the philosophy on which the Commission should base any further action on settlement rates.

AT&T, however, suggests that competition is not enough, and that regulatory intervention is necessary to bring down settlement rates, even in competitive markets such as Canada and Chile.^{9/} Yet the United States' settlement rate with Chile has dropped further than its rate with any other South American country between 1992 and 1996. Moreover, greater competition in Chile has increased outbound traffic to the U.S. more than 120% in the last two years, which has in turn significantly decreased the U.S.-Chile traffic imbalance at the same time that the U.S. imbalance with most other

^{7/} Int'l Pact May Boost Telecom Services Before It Lowers Prices, Network World, Feb. 24, 1997, at 16.

^{8/} NPRM ¶ 69.

^{9/} Comments of AT&T Corp., IB Docket No. 96-261, at 13, 18 (filed Feb. 7, 1997).

countries has significantly increased. Clearly, competition in Chile has reduced the U.S.-Chile traffic settlements deficit, traffic imbalance, and settlement rate.

Moreover, it is the Commission's own International Settlements Policy ("ISP") that has prevented carriers from competing for settlement rates, thereby bringing rates down even further. AT&T's "solution" is to dictate lower settlement rates.^{10/} The Commission, however, has already opted for a more pro-competitive response -- one which will fit well with the elimination of entry barriers across the globe required by the WTO Telecom Agreement.

In its Flexibility Order, the Commission recognized that the ISP does not encourage competitive forces to reduce settlement rates: "where markets are becoming competitive, the ISP's requirements . . . may impede competitive behavior and the development of effectively competitive markets."^{11/} This is the case in Canada, where AT&T Canada (formerly Unitel) provides service on the competitive Canada-U.S. route. To address this problem, the Commission decided to permit competition, not regulation, to structure settlement arrangements on competitive routes. By allowing carriers to compete for settlement terms, the FCC's Flexibility Order will ensure that it is the market, not the FCC, that determines settlement rates on routes like the U.S.-Canada route. This market-based approach offers the surest means to reducing settlement rates in countries such as Canada and Chile.

The Commission is faced today with an environment more favorable to achieving market-based settlement rates than ever before. This favorable environment is due largely to the success of the WTO in concluding an agreement which will unleash competitive forces world-wide, effective January 1, 1998. It is also due to the recent

^{10/} Id. at 16.

^{11/} Flexibility Order ¶ 37 (footnote omitted).

actions of the Commission itself, particularly in its December 1996 Flexibility Order, to harness those competitive forces to reduce settlement rates.

The WTO Telecom Agreement means that most international traffic will originate in competitive markets. It is therefore the worst possible time for the Commission to attempt to dictate settlement rate benchmarks by regulatory fiat. Instead, the Commission should rely on these new competitive conditions to reduce settlement rates. Equally significant, the Commission would also be adopting policies that are fundamentally inconsistent with the specific obligations just assumed by the United States in the WTO Telecom Agreement.

III. THE NPRM's PROPOSALS ARE INCONSISTENT WITH THE GENERAL AGREEMENT ON TRADE IN SERVICES

The NPRM's proposals are not only inconsistent with the general pro-competitive approach of the WTO Telecom Agreement, but are also inconsistent with specific U.S. obligations under the GATS, including both the general obligation of MFN treatment and the specific obligations of national treatment and market access assumed by the United States in the recently-concluded WTO negotiations. There is no exception in the GATS that would permit the Commission to regulate settlement rates in a manner inconsistent with these obligations.

A. The Most-Favored Nation Treatment Obligation Prohibits Discrimination Among Foreign Services Or Service Suppliers From Different Countries

Article II:1 of the GATS sets out the basic obligation of MFN treatment (emphasis added):

[E]ach [WTO] Member shall accord immediately and unconditionally to **services and service suppliers** of any other Member, treatment no less favorable than that it

accords to like services and service suppliers of any other country.

The NPRM's proposals would clearly violate this principle of nondiscrimination by (1) imposing conditions on market access for IMTS providers on particular routes, and (2) requiring settlement payments that vary arbitrarily from the Commission's own estimates of individual country costs for terminating international calls on their domestic networks.

1. The NPRM's Proposed Conditions On Service Authorization Discriminate Against International Services And International Service Suppliers On Particular Routes

The NPRM "propose[s] to condition any authorization to serve [an] affiliated market on the foreign affiliate offering U.S.-licensed international carriers a settlement rate within the benchmark range we are proposing in this Notice."^{12/} In addition, the Commission's other proposed enforcement mechanisms constitute conditions that foreign carriers may provide terminations services over their own domestic networks only based on settlement payments at benchmark rates.^{13/}

Such conditions discriminate among both **services** and **service suppliers** of different countries in direct violation of the MFN obligation. With respect to services, the NPRM's proposals would restrict IMTS on routes with settlement rates not within the Commission's benchmark ranges, but would not restrict IMTS on routes with settlement rates within those ranges. With respect to service suppliers, the proposals would discriminate against service suppliers in particular foreign countries.^{14/} These

^{12/} NPRM ¶ 76. See also id. ¶ 82 (proposing to grant applications to provide switched services over resold private lines "on the condition that accounting rates on the route or routes in question are within the benchmark range").

^{13/} See id. ¶ 89.

^{14/} Discrimination against service providers of particular countries is nearly certain, because both the Commission's affiliation standard and the GATS determination of the

(continued ...)

violations of the MFN principle should be obvious, particularly now that the WTO Telecom Agreement has been concluded. Even Sprint, generally a strong supporter of the benchmark proposal, opposes the application of discriminatory settlement rate conditions on service authorization on grounds of GATS inconsistency.^{15/}

2. The Proposed Settlement Rate Benchmarks Vary Arbitrarily From Cost

The NPRM's proposals would also violate the MFN principle by setting settlement rates that vary arbitrarily from the Commission's own estimates of the costs of IMTS, in two respects.

First, the Commission proposes to impose average benchmarks on groups of countries at similar levels of economic development.^{16/} The proposed averaging of country-specific costs that depend on numerous factors unrelated to economic development is based upon the Commission's assumption that "there generally is an inverse correlation between the level of tariffed component prices and a country's level of economic development."^{17/} Even if the Commission's rationale were

^{14/} (... continued)

nationality of a service supplier are based upon the ownership of the service provider. See NPRM ¶ 76 n.73 (affiliation standard); 47 C.F.R. § 63.18(h)(1) (affiliation standard); GATS, art. XXVIII(g), (j)-(m) (nationality of service supplier).

^{15/} See Comments of Sprint Communications Co. L.P., IB Docket No. 96-261, at 21-22 & n.21 (filed Feb. 7, 1997) (opposing settlement rate condition on grounds including that it "may also violate any WTO agreement that is reached"). See also Comments of GTE Service Corp. ("GTE"), IB Docket No. 96-261, at 30-32 (filed Feb. 7, 1997) (arguing that the conditioning of service authorizations on benchmarks violates the MFN obligation).

^{16/} NPRM ¶¶ 43-53.

^{17/} Id. ¶ 43.

accurate (and in individual cases, it certainly is not^{18/}), it ignores the fact the proposed economic development ranges include countries at widely varying levels of economic development.^{19/} Due to both of these factors: country-specific cost differences unrelated to economic development and significant variation in economic development within ranges -- the Commission's proposal violates the MFN obligation by arbitrarily discriminating among services of different countries.

The Commission cannot have it both ways -- either tariffed component prices ("TCPs") are an accurate estimate of international termination costs or they are not. If they are not, as Telefónica Internacional contends, TCPs should form no part of this rulemaking. If they are, the Commission should not disregard country-specific TCPs by setting average benchmarks. As Sprint states in its comments:

The TCP method is based where possible on data gathered country-by-country; where such data is available, it would be inconsistent with this methodology and potentially unfair to individual countries to average them broadly.^{20/}

Second, the NPRM's proposals are made within the framework of the Commission's International Settlements Policy ("ISP"), which requires equal division of accounting rates between U.S. providers of IMTS and foreign correspondents in most countries.^{21/} Under the benchmark proposal, this ISP requirement will discriminate

^{18/} Id. App. E (TCPs for Guyana (\$0.120) and Nicaragua (\$0.123) are substantially lower than for Japan (\$0.197) and Switzerland (\$0.206)).

^{19/} See id. ¶ 44 (stating that the "middle income" range would include countries with per capita GDP between \$726 and \$8,955).

^{20/} Comments of Sprint at 15-16. See also Comments of Embassy of Japan at 4 (stating that "the gap between the standard and the real cost, as well as the burden of meeting the benchmark, greatly differs for each country of the same [country] group"); Comments of GTE at 33 (arguing that country groups violate the U.S. Government's MFN obligation); Comments of KDD at 25-26 (same).

^{21/} See Policy Statement on International Accounting Rate Reform, 11 FCC Rcd. 3146, 3147, 3149 (1996).

directly and arbitrarily between foreign carriers subject to different benchmark ranges, in violation of the MFN obligation. Foreign carriers with higher benchmarks will be compelled to make larger settlement payments to U.S. carriers, despite the absence of any evidence of differences in U.S. carriers' costs on the routes in question.^{22/} For example, if the U.S.-Mexico benchmark is higher than the U.S.-U.K. benchmark, U.S. carriers would receive higher settlement payments on the U.S.-Mexico route, even though their costs on that route are likely no higher than those on the U.S.-U.K. route.

B. The WTO Telecom Agreement Imposes Additional Obligations On The United States

On February 15, 1997, the United States joined sixty-eight other WTO member countries in making commitments to open their markets for basic telecommunications services.^{23/} The United States committed, as of January 1, 1998, that it will impose no barriers to cross-border supply of IMTS to or from the United States by foreign carriers, and no barriers to commercial presence in the United States of foreign IMTS providers.^{24/} These commitments require the United States to provide both: (1) national treatment (i.e., nondiscrimination between U.S. and foreign IMTS providers to whom market access is provided); and (2) market access. The NPRM's proposals would violate U.S. obligations in both of these areas.

^{22/} See Comments of KDD at 26-27 ("Continued application of the 50/50 policy . . . would not reasonably reflect cost differences among countries and, therefore, it would violate the MFN principle.").

^{23/} See Report of the Group on Basic Telecommunications, WTO Doc. S/GBT/4 (Feb. 15, 1997).

^{24/} Communication from the United States, WTO Doc. S/GBT/W/1/Add.2/Rev.1 (Feb. 15, 1997). The United States reserved the right to apply limited exceptions to its commitments on commercial presence, with respect to (1) direct foreign ownership of common carrier licenses and (2) access to the Intelsat and Inmarsat systems.

1. The NPRM's Proposals Would Violate The U.S. GATS Commitment Of National Treatment

GATS article XVII:1 sets forth the basic obligation with of national treatment:

[S]ubject to any conditions and qualifications set out [in its GATS Schedule], each [WTO] Member shall accord to services and service suppliers of any other Member . . . treatment no less favorable than that it accords to its own like services and service suppliers.

The NPRM's proposals would discriminate against foreign carriers in violation of this provision in two respects.

First, the Commission proposes to impose settlement rate benchmarks as a condition of entry only on foreign-affiliated carriers.^{25/} This approach would violate the national treatment obligation because foreign-owned IMTS providers are far more likely than are U.S.-owned IMTS providers to be foreign-affiliated. In fact, by proposing an affiliation threshold of twenty-five percent foreign ownership,^{26/} the Commission substantially excludes AT&T, Sprint, and MCI (pending approval of the BT-MCI merger) from application of settlement rate benchmarks, notwithstanding multi-billion dollar foreign investments in these carriers and the carriers' participation in major foreign alliances, e.g., World Partners, Global One, and Concert.

Second, while the Commission proposes to regulate the price charged by foreign carriers for provision of the foreign half-circuit for U.S.-originated calls (i.e., the foreign settlement rate), it would not regulate the price charged by domestic carriers for either (1) the domestic half-circuit of the same call (i.e., the domestic collection rate), or (2) the domestic half-circuit of a call originated abroad (i.e., the domestic settlement rate). The failure to regulate the latter charge at cost results from the Commission's

^{25/} NPRM ¶ 76.

^{26/} See id. ¶ 76 n.73; 47 C.F.R. § 63.18(h)(1).

adherence to the ISP requirement of equal division of accounting rates, notwithstanding evidence that the costs of U.S. carriers are lower than those of nearly all foreign carriers.^{27/}

It is no answer to these national treatment violations that the NPRM would apply equally to either a U.S.- or foreign-owned carrier that has a foreign affiliate on a particular route.^{28/} Decisions under the WTO Agreement and the General Agreement on Tariffs and Trade ("GATT 1994") make clear that a facially-neutral measure that has the effect of discrimination against foreign companies violates the obligation of national treatment. For example, in the Panel Report on United States - Standards for Reformulated and Conventional Gasoline,^{29/} a WTO panel "rejected the US argument that the requirements of [national treatment] are met because imported gasoline is treated similarly to gasoline from similarly situated domestic parties."^{30/} Because foreign gasoline was "effectively prevented" from receiving the more favorable treatment accorded to **most** domestic parties, the panel concluded that a national treatment violation existed.^{31/} Furthermore, the first WTO panel to address the GATS has explicitly stated that "formally identical treatment may . . . be considered less favorable

^{27/} See Comments of KDD at 26-27 (mandating "the 50/50 division of tolls that systematically overcompensates U.S. carriers . . . while purporting to prescribe cost-oriented settlement rates for foreign carriers simply cannot be squared with the National Treatment principle").

^{28/} See NPRM ¶ 79.

^{29/} WTO Doc. WT/DS2/R (Jan. 29, 1996), aff'd, Report of the Appellate Body, WTO Doc. WT/DS2/AB/R (adopted May 20, 1996).

^{30/} Id. ¶ 6.11 (relying on Panel Report on United States - Measures Affecting Alcoholic and Malt Beverages, BISD 39S/206, ¶ 5.19 (adopted June 19, 1992)).

^{31/} Id. ¶ 6.10.

treatment if it adversely modifies conditions of competition for foreign services or service suppliers."^{32/}

In a proceeding in which it explicitly seeks to attack a perceived "major subsidy from U.S. consumers, carriers, and their shareholders to foreign carriers," the Commission cannot credibly contend that its proposed regulations do not favor U.S.-owned carriers. While such preferential regulation may have been permissible before the WTO Telecom Agreement after January 1, 1998, it will constitute a violation of GATS obligations of national treatment assumed by the United States.

2. The NPRM's Proposals Would Violate The U.S. GATS Commitment Of Market Access

Article XVI:1 of the GATS sets out the basic market access obligation:

[E]ach [WTO] Member shall accord services and service suppliers of any other member treatment no less favorable than that provided for under the terms, limitations and conditions agreed and specified in its [GATS] Schedule.

The NPRM's proposals would explicitly violate this provision by conditioning service authorization for affiliated markets on settlement rates within the benchmark ranges,^{33/} and by adopting enforcement mechanisms that authorize services only based on settlement payments at benchmark rates.^{34/} Nothing in the U.S. commitment in the WTO Telecom Agreement (which is incorporated into the U.S. GATS schedule) authorizes such conditions.

^{32/} Panel Report on European Union-Regime for the Importation, Sale and Distribution of Bananas, ¶ 7.309 (confidential interim report), reprinted in Inside U.S. Trade, Mar. 28, 1997, at S-2, S-8.

^{33/} See NPRM ¶¶ 76, 82.

^{34/} Id. ¶ 89.

The Commission cannot seriously defend its statement that the benchmark "proposal does not serve as a barrier to market entry for foreign carriers."^{35/} In fact, the Commission itself recently concluded in the Foreign Carrier Entry proceeding:

that requiring cost-based accounting rates as a precondition of entry could preclude otherwise qualified candidates from competing in the U.S. international services market. **It would become, in effect, a barrier to market entry.**^{36/}

Furthermore, article V(e) of the GATS Annex on Telecommunications^{37/} provides:

- (e) Each Member shall ensure that no condition is imposed on access to and use of public telecommunications transport networks and services other than as necessary:
 - (i) to safeguard public service responsibilities of suppliers of public telecommunications transport networks and services . . . ;
 - (ii) to protect the technical integrity of public telecommunications transport networks or services; or

^{35/} Id. ¶ 79.

^{36/} Market Entry and Regulation of Foreign-affiliated Entities, 11 FCC Rcd. 3873, 3898 (1995) (petitions for reconsideration pending) (emphasis added).

^{37/} Article V(a) of the GATS Annex on Telecommunications makes clear that the article V(e) defines permissible market access conditions for foreign telecommunications service providers granted access to the U.S. market:

Each Member shall ensure that service suppliers of any other Member have access to and use of public telecommunications transport networks and services on reasonable and nondiscriminatory terms and conditions, for the supply of a service included in its Schedule. This obligation shall be applied, inter alia, through paragraphs (b) through (f).

- (iii) to ensure that service suppliers of any other Member do not supply services unless permitted pursuant to commitments in a Member's schedule.^{38/}

This provision indicates that a requirement of a cost-based settlement rate is not a permissible condition on service provision by a foreign company granted U.S. market access under the GATS. In sum, the inconsistency of the NPRM's proposals with U.S. GATS commitments of market access could hardly be clearer.

C. The NPRM's Proposals Are Not Permissible Under Any GATS Exception

The GATS obligations discussed above are effective unless a GATS exception is applicable. The exceptions of the GATS are specifically defined. They relate to emergency safeguards (article X), balance of payments safeguards (article XII),^{39/} government procurement (article XIII), security exceptions (article XIV *bis*), and certain general exceptions (article XIV). None of these exceptions is applicable to the NPRM's proposals. Furthermore, the Commission cannot manufacture another exception under article VI of the GATS or create a "competition exception."

^{38/} See also GATS, Annex on Telecommunications, art. V(f) (certain specified "conditions for access to and use of public telecommunications transport networks and services" may be imposed only "[p]rovided that they satisfy the criteria set out in [article V(e)]").

^{39/} The balance of payments exception applies to "serious balance-of-payment or external financial difficulties" of a **country** that is a WTO Member, GATS, art. XII:1, not to commercial imbalances in settlement payments under private contracts between highly profitable telecommunications service suppliers.

1. **Article VI Of The GATS Does Not Provide An Exception To The Obligations Of MFN Treatment, Market Access, Or National Treatment**

Article VI of the GATS, which relates to domestic regulation, provides that "each Member shall ensure that all measures of general application affecting trade in services are administered in a reasonable, objective and impartial manner."^{40/} The establishment of this **affirmative** obligation, which is the plainly-stated purpose of article VI, in no way creates a GATS exception for domestic regulation that violates obligations of MFN treatment, national treatment or market access.^{41/}

In fact, article VI:4 of the GATS, further demonstrates the inconsistency of the NPRM's proposals with the GATS. It provides that "measures relating to qualification requirements and procedures, technical standards and licensing requirements [may] not constitute unnecessary barriers to trade in services," and must be:

- (a) based on objective and transparent criteria, such as competence and the ability to supply the services;
- (b) not more burdensome than necessary to ensure the quality of the service; [and]
- (c) in the case of licensing procedures, not in themselves a restriction on the supply of the service.^{42/}

The NPRM's proposals are inconsistent with these criteria because they: (1) are not related to competence or ability to supply services; (2) would plainly be "more

^{40/} GATS, art. VI:1.

^{41/} The Report of the WTO Appellate Body in Japan - Taxes on Alcoholic Beverages, WTO Doc. WT/DS8/AB/R (adopted Oct. 4, 1996) indicates that the entirety of article VI must be read in terms of the affirmative obligation set out in article VI:1. See id. at 17 (noting that GATT 1994 article III's national treatment provisions must be read in light of article III:1).

^{42/} GATS, art. VI:4.